THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

TSCO.L - Tesco PLC Update Presentation

EVENT DATE/TIME: JANUARY 08, 2015 / 11:30AM GMT

OVERVIEW:

TSCO Tesco PLC Update Presentation.

CORPORATE PARTICIPANTS

Dave Lewis *Tesco plc - CEO*

Alan Stewart *Tesco plc - CFO*

CONFERENCE CALL PARTICIPANTS

Bruno Monteyne *Sanford Bernstein - Analyst*

Dave McCarthy *HSBC - Analyst*

Clive Black *Shore Capital - Analyst*

Mike Dennis *Cantor Fitzgerald - Analyst*

John Kershaw *Exane BNP Paribas – Analyst*

David Cumming *Standard Life – Head of Equities*

Jaime Vazquez *JPMorgan - Analyst*

Rob Joyce *Goldman Sachs - Analyst*

Arnaud Joly *Societe Generale - Analyst*

Kate Pettem *Rathbone Brothers Plc - Analyst*

James Grzinic *Jefferies - Analyst*

Rickin Thakrar *Espirito Santo Research - Analyst*

Charlie Storey *Macquarie - Analyst*

James Collins *Oriel Securities – Analyst*

Xavier Le Mene *Bank of America Merrill Lynch - Analyst*

Pradeep Pratti *Citigroup - Analyst*

PRESENTATION

Dave Lewis - *Tesco plc - CEO*

I suppose it's a day, in fact it is a day, for Tesco which is very particular, and I think it's a day that has very much some mixed emotions in it. Because what I'm going to share with you today I think we -- has an element of improvement in our business performance and it's an improvement in our business performance that's been driven by a whole group of very passionate people who have really got back on their game over the last three months. There's much more to do but some things really to be encouraged by.

But it's also a day where we've had to announce some pretty significant changes to our business with quite a significant impact on colleagues, communities and indeed other stakeholders. So it's in that context that I update for you today what I said we would do. We'll talk to you about the trading in the third quarter, we'll talk to you about the trading specifically over Christmas; and then we'll go, as I also said we would do, and update you against the three key priorities we set for ourselves. But obviously you've seen some of that already in the announcements.

I suppose what I should say is obviously the reason -- there is a very specific reason we're having this discussion at 11.30 rather than earlier, as we normally would, and that was so that after we had made the release to the marketplace, the priority was for me and Alan and the leadership team to be talking and explaining the changes that we've done to the colleagues in Tesco as a key priority, and I hope you understand why it is we did that.

So what I'm going to talk about is I'm going to bring you up to speed since we last met, and I do that so that -- as I said, I don't want these to be one-off presentations; I want this to be a building of an ongoing dialog. So I'll build a linkage back to what we did before and I'll take that into the Q3 results and Christmas. And then we'll update on the key priorities and I'll share with you a few thoughts on the way ahead.

What Alan and I have agreed in this particular occasion is I will actually -- I'll do the presenting and he'll answer all the difficult questions. But in order to keep the flow quickly I'll take you through the presentation and then we'll both take any detailed questions that you've got.

So look, if you remember back, it was October 23 we first met. We had a conversation about commercial income issues that you will remember, and I certainly will. And we set out the three important priorities and immediate priorities. We had to come back together on December 9 against -- we didn't give any guidance but obviously against what the market had thought as we worked through the commercial income, we came back and gave guidance of a profit of no more than GBP1.4b. And here we are today to update you on the priorities.

If you remember, on October 23 I talked to you about the opportunity. Alan and I talked to you about the opportunity that we saw coming into the business around service, availability and selectively on price. And we talked specifically about the order with which we wanted to invest in the service proposition, the availability for our customers and then, when those were improving, being able to selectively invest in price.

So what have we been doing? And you've heard some of this from me already. We have, since that time, recruited more than 6,000 colleagues to work in customer-facing roles in store. That means a significant investment in more than 2m hours more serving customers. We talked at the time -- everybody had a story for me of walking into a Tesco store and not being able to find a colleague who could serve them in the way that they wanted at one point or another. This was a very deliberate attempt for us to do something about that and it was also an attempt in the last thing, which was Feet on the Floor, to reconnect the stores with the head office.

And so since the time we've met, and you would have seen some of this, we have every Thursday, Friday had 6,000 -- between those two days each week for the last nine weeks or so, 6,000 colleagues from Cheshunt and Welwyn Garden City have been joining stores every other week. So each person has been going once every 10 days to the same store, being part of the team working in store.

Now honestly, much more significant than I think people gave it credit for, for two reasons. One reason was a very significant investment in more people to actually be helping address the service and the availability I talked about. But very important, and one of the key things of it -- and the reason I'm saying this I'm going to come back and share with you some things that have come from it -- is it was a way of reconnecting the head office with the store and re-orientating our business to a place that says actually the store is the center of everything that we do. That's where the reality takes place and everything else in the business is supporting that store customer-facing experience, and therefore, as a Group, were we doing that in the best possible way. And by taking from colleagues from the center to the store, that has yielded a huge amount of insight and understanding and change for us. So not to be underestimated.

What's happened? I'm going to share with you some detail now that you won't have seen before. So for those who are familiar, we every week across all of our formats, across all of the country, we survey customer reaction. That's what we call customer viewpoint. And what you see here is week 32, Tesco week 32, all the way through to week 44 which is basically Christmas week. And what I'm showing you is this is customer feedback. So customers give feedback. It's a statistically robust sample; it rolls every week across all the different formats. And basically if you take the dark line -- so in all of these I've given you all the regions so you have a sense for it, but this is total Tesco.

So back in week 32 customers' ratings of our overall service and the colleague helpfulness as being excellent was somewhere around a 50% feedback. What you see over the course of that, as always these things are never smooth but we've managed to get a feedback which is significantly greater than that through that period. So customers were telling us that actually they were feeling that investment in service and indeed that step-up in terms of colleague helpfulness.

One of the things that we asked them in that survey and other surveys is around I don't queue. So in the evenings, particularly in the evenings, did I have to queue in order to get out? And back in again Q2 the base there was 10% of people complaining that they were having to queue. And with the investments that we were making by the time we got to week 43 just before Christmas week we'd got that down to nearly 4.5%. So we'd halved the number of people who were experiencing a problem with queuing and therefore having a better shopping experience with us.

We did get back. Christmas week is Christmas week and there is definitely more traffic so you see that come back here. But it's interesting to me that in total Tesco that actually Christmas week still had less queues than we were having back in week 27 and 28 when nothing was happening.

The other part we talked about was the opportunity and availability. And again, taking you back to the conversation we had before, we measure our availability in a very robust way historically based on Dot com picking. And it's a fantastic -- never is there a more deep sample of picking to tell you what the availability is. But, let's be honest also, it happens first thing in the morning after the shelves have been filled overnight and it's picked by expert pickers who know where everything in the store is.

The thing that I was interested in when we talked about last time was what happens when you come to the store at 8 or 9 o'clock in the evening when the store has been shopped all day, what availability is it then. And I told you about a plan that we had to put in an availability tracker which was sales based in the evenings so that we could track whether the availability was there.

It's not as big and as robust as the Dot com one is yet; it's still in a pilot stage. When we first ran it, it showed us that the availability at that time was around 88%. It was around 88%. So that gives you some indication -- we wouldn't make them as robust as that but some indication of the difference of what it was at 8 o'clock at night versus where it was in the morning. And over the last eight weeks we've taken that 88% to 93%.

Now in fairness you're not looking for the 93% to become 98% because if we're 98% available at 9 o'clock in the evening I'm going to have a problem with waste and other things. But actually we want to be much closer and we can see that the change that we've done in the way that we manage stock and availability -- and I'll come onto that -- has had a material difference.

I also said that we would take the 1,000 lines that are most bought in the store and increase the space. Because the other thing that happened we talked last time about the range density, the increase in 31% of the range in Tesco over the last 18 months or the 18 months prior to September, and what that was doing to contrast and compress the range that we had in our stores. And that was making the big high-volume lines sometimes the lines that were least available at those busiest times.

We managed -- because we were doing this off our range review, we managed to execute 250 of those in the run-up to Christmas so there's still more that we can do. And we saw quite a significant impact for those. And if you want to track that, if you want to look at it in store, as you walk through the store look for the red stars. They're the 1,000 most important lines in that store and they're the ones that need to be constantly available. So we made some progress, some real progress in terms of driving up and improving the availability.

What did our customers say? Again, same metric, back to week 32. These are customers who were strongly satisfied with overall availability. Back down in week 32 we're talking around let's say 60% and week of Christmas, which is normally a big challenge we're talking about more than 70%, in fact it was 71%, 72%. So the availability measures by customers fed back to us was a real strong improvement through that period.

The final thing we talked about was the opportunity to selectively invest in price. And what we've done, and that was linked to those 1,000 lines, it was linked to a -- just a view that said for those lines which are most important, where the volume is, did we have the right pricing strategy. For those who have heard me talk on this before, we talked about lettuce and some of the lines where we just increased the amount of space. We reduced the range, we increased the amount of space and we went from a promotional program to a price program, depending on the category, depending on the product. And we saw some significant improvement from doing exactly that, and I'll talk about produce in the UK in a second.

We also had an opportunity to test out a new way of thinking around category reviews. And I know I've talked to only a few of you in the room but let me share with you this, because actually in this one there's some lessons as to how it is we're going to be thinking going forward.

In the time that Alan and I have been here we've only done one major reset apart from Christmas but category reset and that was in homecare, in household. And the bit of that category review that I'm going to talk to you about now is the area of household paper, household paper being toilet tissues, kitchen tissues, etc.

This is a category where we took out a little bit more than 40% of the SKUs. So we -- 31 was total, in this category it was 44%. What we were finding, and for those who are very familiar with the retail operation, is paper is a very particular category. It's very bulky, lots and lots of space. If you for whatever reason get yourself to a place where the range is too intense, then the space that's available for the most wanted lines in terms of volume becomes tighter and the only way you keep it on shelf is you apply more and more labor to keep filling it through the day.

What we chose to do here was reduce the range, increase the space to the big volume lines, and what we've seen through that is that we've seen we were able -- two other things -- we were able with our suppliers to negotiate significantly different terms for reasons I'll come onto in a second, and that reduced the price to the customer on average for that category of 11%. And what we saw, and what we're seeing, because it was week 41, 42, we're seeing that come back to us in volume.

A couple of things are important about this category, and the reason I normally -- I use it outside of household is this is a great example of where you sit down with your suppliers and think about a category completely differently which is that the economics for us are the space on shelf, but then you take all of that range and you think about the space in the back of the store for stock and replenishment, and then you think about it in the lorries and the distribution all the way back up the supply chain. There's a lot of stock hold.

If you also say that we as Tesco run a high-low promotional campaign and if I'm a supplier the capacity that I need for when Tesco is promoting is really very significant because that spike in volume can be really quite significant. And if you're interested in paper mills, they're incredibly capital intensive. So actually by sitting down and saying with those select suppliers, so customer first, which is the ones they most want, with our suppliers sit down and say actually lower SKU count but more volume runs on the big volume lines, more consistently, not with a promotion program but we put it into price.

And the joke that one shouldn't say at this point is it is fair that toilet paper does not -- consumption does not increase as a result of promotional activity. Larder building may but consumption I don't think does. And therefore you take it out and that allows you to run the program. So I can fill it once overnight; I don't have the same space issues in the back of my store, nor in the depot, nor in the lorry, nor in the warehouse. But my supplier can also then run his or her operation in a much more simple, much more streamlined way and have benefits as well. And that's why we were able to negotiate a reduction in price for the customer without affecting the commercial margin of Tesco.

So long story but it gives you an insight into when I talk to you later about thinking through category resets, that's the sort of example that I mean.

The other thing we did, and some of you will have seen this, is we were very selective about where promotionally we made some investment in price. One of the things I think Tesco historically has done very well is think about what it is a customer wants at a particular point in time and make that more accessible, good quality, good price. And that's what we did at Christmas with the Festive Five, the five vegetables that we know people most want in their Christmas lunches were the ones that we priced, quality, promoted in the right way and that was phenomenally successful for us, some [16m] portions of that were consumed over Christmas. So that's what I mean by selectively investing in price.

And interestingly, this is what customers said. So again same metric, week 32 something around 37%, 38%, 39% agreeing with the statement of being satisfied with the prices paid. And actually to week 44, getting that up to 55%, 56%. It's still not enough. I don't know whether customers will ever be completely happy with price. But I suppose what I'm trying to show you here is we have selectively changed what we've been able to change; we've had feedback from customers that they appreciate it and they recognize what it is we've been doing for them.

The other thing we've been doing since we last met -- and each one of these things we could spend a period of time on but you'll be pleased we're not going to -- is we've launched an initiative -- this links back to some of the things I talked about in Feet on the Floor -- which reduces the administrative workload in a store by 75%, in order to give colleagues in store more face time, doing what they do best, which is serving customers.

And if you do get a chance to ask colleagues about it, they will tell you this is it. And this comes to a place, it comes back to the Feet on the Floor which is when you spend that time in store and you see the routines that are happening, it gives you a chance back at -- to say actually do I really need to do that. And I don't criticize here. I've had this experience in other businesses which is -- and it particularly happens when -- when your business is not performing it's almost a reflex of head office to ask more questions why. And so what you do is you go back to the frontline and you're looking for all sorts of indications as to why. And if that happens over a period of time you then get to here and you look at actually the store spending most of its time answering the questions in order that people can understand what's going on. All well intended but not spending their time in store.

So what we've done is go back, and again Feet on the Floor helps you do this sort of thing because you say actually the orientation in this business is the stores are not there to serve the head office; the head office is there to serve the stores. How can we make their lives easier so they can spend all of their time with customers? So that's something that's happened and continues to happen.

The other thing, and I talked to some of you in different presentations about the fact that as we had increased the SKUs that over the last three years the stock growth in Tesco was some three times what the improvement in sales had been and I didn't want that trend to continue. And what you see here, I thought you'd be interested, is as we've run the business in the way that you have just heard me talk about, during that period we have reduced the stock cover in our business by nearly three days versus the same period a year ago.

So it comes back to the benefit of if you can get the flywheel moving on volume and you get the range right and you run the business in a particular way, there is a very big operation efficiency that can come from that. And as you see here, I've split it between food, hardlines and clothing, but that's a significant improvement in the operation of the business in a relatively short space of time.

And finally service. Finally service. And again, I'll talk to you about people who really understand retailing. Small touches at one point. For those of you who entered a store in the UK around Christmas time, you probably met a greeter, somebody who actually welcomed you into the store. And as it got busier at Christmas time you probably met somebody at the till who was also helping you pack and if necessary take your things to the car.

Going back -- I've said it to a number of people, I think that what we did as a business at Christmas which was significant is we got back to what Every Little Helps really means. And actually people were doing small things that made a big difference for customers in store. And the team wouldn't let me put a picture up there but I'm going to tell you about my favorite one. My favorite one of this was -- there's some great stories but my favorite one is the following and I can say this because it had absolutely nothing to do with me.

Who has heard of the Tesco Turkey Taxi? Probably nobody. What the team did -- so if you remember, what I said before was I invited everybody who works for Tesco to think of a way that every day they went to a customer and gave a customer an experience that they didn't expect from Tesco. That's all, just one a day. 320,000 people, one a day, big marketing initiative, big way of change in behavior.

A team of people -- the Turkey Taxi were people who set up, looked on social media for those people, those customers who had either had a -- and we've all had them -- a turkey disaster in cooking or, dare I say it, a failure to deliver or some form of Christmas problem. And literally -- and I've got some wonderful pictures -- these guys went along, our guys went along and completely out of the blue, to people who weren't expecting it, delivered them a turkey so that they could recover their Christmas experience.

This is the sort of thing that's happening. When you encourage people to be part of a service orientation, my God do they react in a very interesting and very inspiring way. So anyway, the idea of service was also I think evident as a start in the fourth quarter of last year.

So what did that do? What did that do? So let's talk about the numbers. You would know this because you've seen the release. What I've done for you here is break it down geographically. All these numbers are including VAT, excluding fuel. You see the trend from Q2 -- let's take the UK, (5.4)%. For the quarter was (4.2)%, for Christmas period was (0.3)% negative. And so for the 19 weeks that's something like 2.6%, 2.7% from (technical difficulty). So an improvement on where we've been. I'll talk about some of the highlights in a second.

Asia was an improvement over Christmas but we've got a couple of things in Asia it's worth commenting on. So in Korea we're still affected by the DIDA. So we had -- for those who are interested in this detail, you do ask me when I come around, 19 more days became -- 19 Sundays became taken out and replaced by weekdays so we've got that still happening. In Thailand there was all the unrest that you know about and in Malaysia we had the issue with imported goods. So we've had some challenges in each of the Asian businesses.

Europe improved, significantly improved, in Christmas went positive, and there's been some really nice performances across Central Europe, and as a result that's where we stand as a Group.

I'll give you a bit more detail. This is total sales and so actually at Christmas time in the UK total sales constant rate was positive for the first time in quite a long time. And as a Group we were positive for quite a long time and you see the split by region there.

I'll give you some more detail. This is what it looks like in terms of the UK, 2012/2013, 2013/2014 and then the quarters. So you can see there is a trend that we like. We know it's only one six-week period so we're absolutely not getting that out of perspective but it shows an improvement and an outcome from that trend of service. So when people say why do you think it is, I go back and say it is something about service, availability and selectively on price. That's what we've done and this is where we are.

When you look at it, the split between food and non-food, whilst food was still negative it's a big improvement and it's also quite significant in its weighting for our business. So actually the turnaround in food is a big contributor. And here as well that stat that was in the release is important. This is the first time -- so you all know that there's deflation in fresh produce. This is the first time in five years that we as Tesco have managed to have volume growth in fresh food during this period. And that comes back to what it was I was saying to you about availability, price, and indeed quality.

And in non-food we had a real step-up. We had a real step-up. And that was both in store and online, in store and online, but a very good sales experience through the Black Friday. Some lessons to be learned about how to run that exercise (inaudible) in terms of in store for the future but a very strong performance in general merchandise.

And detail we don't normally give but I wanted to share with you. I said I'd give you more details. So if you look at it by format in terms of Extra, Superstore, Metro and Express, all formats are improving.

I suppose the point I would make here is I think there was some speculation just before Christmas and I've seen lots of things in the press about Tesco losing out in convenience and Express. I honestly don't know where that came from. This level of performance is very competitive in that sector. It's an outperformer versus the market. So I don't know where that came from but that clearly wasn't the case.

So I suppose what I'm saying is it was a broad-based improvement in our business. All categories, all formats, all channels stepped forward through the period.

And indeed to that point, this is what the split is between stores and the three main online businesses. Very strong growth in all of the online businesses. Grocery home shopping, strength to strength, regaining market share, but a really good performance across all.

And this is a new chart. This is a new chart. And I don't know who follows what so Kantar we won't get until next week so everybody's looking for performance versus the market because we're all quite competitive people at heart. And what I'm going to show you now is IRI data, so EPOS data for those who are not familiar with the UK. And this is a measure of performance versus the market. So what this is is all of the seven big super categories if you like and this is Tesco's performance between weeks 40 and weeks 44, so December.

And what we see is that actually when I say winning across all categories you can see that actually our volume performance in all seven categories was better than market and in value six of the seven were better and the investment in fresh meant it was just ever so slightly value negative. So that's the only indication I can give you against the performance versus the market at this point.

Which brings me to here. It brings me to here. And I did desperately want to stop here given how I started this presentation. But there's another reason I wanted to stop here because as somebody who's relatively new to the business the -- I want to tell you something that I saw and something that I experienced. I saw a group of very talented, very experienced people. There are a lot of very good retailers in Tesco.

So for all of those thinking that there was a talent drain, that somehow there was a vacuum, let me tell you that's definitely not the case. This is a team of people who've just played a game that they know very well and they've played it very well. And it's really important that I give credit to them. I saw some fantastic expertise and passion through that period and people got a chance to express themselves in a very particular way. And any time I should say thank you but especially at a time when we're saying thank you for doing that role. So in announcing some other things, it's really important that I recognize the contribution of the colleagues in Tesco because I can say this to you, it's been an inspiration to be around. They've been absolutely phenomenal.

And the nice thing is I think if you talk to them they would say that for them Christmas and the way we ran Christmas was one of the smoothest they can ever remember, and a lot of them have been there a very long time.

So that's where we are. That's the results, that's Christmas, that's what we're up to. Let's talk about some changes. What's coming next? So two changes you would have picked up on. I made some announcements to the executive committee in December and we're announcing two more today. The consolidation of the two internationals -- so at the minute we have two people on the exec, for those who are not familiar, between Asia and one who does Central Europe and Ireland. The idea is to consolidate that back into one person who will run international for Tesco. And that person is Trevor Masters. Some of you will know Trevor. Trevor is a 30-year plus veteran of Tesco and an outstanding retailer.

It does mean, and I want to give credit to him, it means that the role that Ken Towle had in our business is now redundant and Ken is again somebody who's been 30 plus years within Tesco and been significant in Dot com and UK, in China, in a variety of roles. So it's with some sadness that that role is redundant and he will leave us at the end of this financial year. But it does mean that we can consolidate and bring together the international operation.

Second is the announcement we made this morning that Matt Davies will be joining us. Now some of you may know Matt from Halfords or his previous incarnation. I'm delighted that Matt's decided to join. He's going to be the CEO of the UK and Ireland; we're bringing that operating unit back together. So we'll run Ireland alongside the UK, not as part of Central Europe as we currently do. And Matt will join us at the end of May. Now Matt brings a huge amount of experience, both in retail but also in terms of turning around businesses, but he also has not only a huge amount of capability, he has a particular set of values which is important to me in terms of how it is we lead the business going forward. So I'm delighted that Matt is joining the team.

We said we had three priorities; regaining competitiveness in the core UK business, protecting and strengthening the balance sheet and rebuilding the trust and transparency of the brand and the business. What have we been doing? This one simple chart is probably as close as you're going to get to a UK strategy I'm afraid, for reasons I explained to you back on October 23. And I've taken 2015. I think you've seen what we've done over the last three or four months and if I were to just take the calendar year of next year, there are going to be three things that you're going to see from us.

You're going to see a continued every day, every week, every store customer face retail excellence. Back to that service, availability, stock, management of stock and price integrity, every day, everywhere. The thing that I'm -- it's that absolute broad spectrum of getting it right every day, permanent attention.

We'll roll through on those category range resets I talked to you about. We don't review everything at the same time; we roll them through. So that will happen through the course of this year (technical difficulty) these categories as and when is most appropriate in terms of the lead time and the review.

And then there'll be another bit which is in that box at the bottom which is giving customers some new reasons to re-believe, giving them some incentive and some way of engaging with Tesco which will be new and will be different. And there'll be many of them.

The first of those was on January 1. So for those of you who picked it up, in terms of sweet-free checkouts. All formats, all checkouts from January 1. We think that's industry leading. We've done a lot in terms of healthier options at the point of sale. And what I thought I'd share with you is something that people -- and we've not really communicated I think probably well enough is what it is the team have been doing for a while in the whole area of healthier eating.

So within Tesco 3bn calories removed from soft drinks, Tesco soft drinks. Absolutely colossal number when you look at it. You talk about what it is with Tesco; if you can make some small improvements and you times it by the volume you make a big difference. This is one of them. And then it can either be more portions of fruit and veg that have been added to ready meals. I could have put up here fat reduction, [salt] reduction and things such as that. There's a whole stream of innovation which is about healthier eating which we can bring to our customers and we will.

And then there was this. Could we run the video please?

[Video playing of Tesco advert]

So that started today. We want to give time for the checkout just to land. This is a recognition and listening to customers in a different way. What were they saying to us? They were saying -- back to that discussion on pricing -- we're looking for lower, more consistent pricing. And when you look at that in more detail, where do they want it. They want it on the things that are important to them, so what we call the nation's favorite brands. And we've looked at in the marketplace at the end of last year which of those nation's favorite brands were we most out of line on everyday pricing. And in fairness there's been promotional activity in there and we've taken -- and it's about 300 lines, about 300 SKUs and we've taken initiatives to lower those prices on those brands from today. On average, if you take that whole basket, that's a reduction in everyday price to customers of about 26%.

Now the interesting thing about brands, before you ask me the question at the end, is obviously it's an easy point of comparison. When I grew up in the industry people used to talk about brands being the currency of competition because it's what customers can relate from one store to the other to the other.

So as it is we establish what I would want around price integrity. It's the right place for us to start. And it's also the place, by the way, that when you looked at it versus competition where we had some of the biggest gaps in our pricing.

So we've made the change; we'll communicate the change. It's in store today. And then we'll listen to customers and we'll see what they think. And everybody asks me is this a complete change. We've made this change and it will be a constant evolution about what it is we do. As I said before, there'll be lots of reasons to re-engage. But this is a significant move from us in terms of brands, the unit price, not promoting on some of the nation's favorite brands.

What else are we doing in terms of regaining the competitiveness of the business? And this comes to the announcements this morning around restructuring. For those who remember, on October 23 last year I talked about what had happened to the Group overhead. In fairness as it was thinking about building out a Group which was more global than the one that we have now, it had West Coast, North America, it had Japan. But actually there had been a 30% increase in the cost of the Group overhead. And what we've communicated today is we will -- we have set ourselves a target to reduce that cost by 30%.

Everybody's going to ask me what does that cost mean in terms of numbers of roles. And the short answer is we don't know that yet because we're going to do that through consultation. We'll start at the top and we'll work down and we're going to save 30% of costs. When the consultation is done and when the design is complete, with the involvement of the leaders of the business we'll tell you what that means in terms of numbers of roles. But that's the right and responsible way of doing it.

The thing that's also significant in there is that once you do do that it's very clear -- and again I said this on October 23 -- that we don't need all the head office space that we have within the UK to support the activities of the UK and the Group. And so we've announced today that we will consolidate all of the head office into Welwyn Garden City and that means that we will close the office in Cheshunt. That will happen first quarter next year.

That's point one. Partly from that restructuring but partly from some of the changes we're going to make in management structures in store, what we've said is we will gain -- we're looking for at least GBP250m per year of cost savings from those initiatives. It will cost us a one-off restructuring charge of around GBP300m to get that. The important thing, and I'll come back to this later, is you should see that cost reduction as ammunition for me to invest back in sharpening yet further the customer proposition and not in the near term around margin improvement. There's more that I would want to do for customers. We'll talk about that a little more.

We've also (technical difficulty) and we're still doing a very full property review. But when you look at it through a property lens we've announced today we're going to close 43 unprofitable stores in the UK. They are stores across the estate. So they're across all formats. Numerically slightly more than half are in Expresses. For reasons which I hope are obvious we're not giving out the list of those stores. We're going to work with the colleagues in those stores privately first before we in any way communicate that. But it's so significant that we would want to disclose it today.

And finally, before I came to the business there was some work ongoing to look at a different way of running stores from a management team point of view, streamlining, simplifying. It goes back to that 70% less workload and how do you run the store. And there's been a test ongoing across a wide range of stores over a long period of a new model. That new model has been positive, both in terms of customer viewpoint and colleague viewpoint. So we've taken the decision to take that across the whole of the estate in the UK.

That's all about getting simple, more simple, more agile, more lower cost, but importantly taking that and applying it back to the customer proposition.

So competitiveness in the UK. That's what we've been up to and that's where we are. Protecting and strengthening the balance sheet. There were five things that we said we would be looking at. So let me tell you about each of them. So in property, in our property pipeline we announced today that there are 49 sites. Now these -- let me be clear, these 49 sites are sites which were for big stores, big stores. And some of these projects have been around for a very long time and they were around for a very long time because it can take a while to build up the parcel of land to be able to build a big store.

But actually when you look at those stores, when you look at the environment, you look at the market, you look at the capacity and you look at the economics, and by the way you then look at the capital I would need to be able to build them out and you say that's not a very sensible thing for us to do. So we've taken a very specific decision to abandon those projects and this morning we wrote to the communities that were involved in those to inform them that unfortunately we wouldn't be able to go on and build out those stores.

Now it's about 2m square feet of sales space that would have been built that will now not be built. It's 49 stores across the country. And it's part of an end-to-end property review that we started, Alan and I, when we came in and is still ongoing for other reasons. And I'll come back to it. But that was something we announced this morning.

The other thing we announced this morning was the commencement of consultation, consultation on pensions, consultation about closing the defined salary pension scheme to all employees within Tesco. Now clearly it's an important benefit and we do need a period of consultation. The valuation takes place in May and the consultation will happen all the way through June and then implementation is scheduled to be in February 2016. We can ask Alan some questions about that when we get there. There's an investment from Tesco in order to be able to make the move but we think that that is the right thing based on the financial profile of the Company and also the need to give a more consistent proposition to our people long term. But clearly a big change for colleagues within the UK.

Capital expenditure reduced to GBP1bn. This year we're talking about GBP2.1bn, GBP2.2bn. A very particular focus on productivity and short-term returns from that capital investment given the nature of the finances of the Group. And for those who are going to ask us questions about where that capital is, there is a very specific pie chart around the split between capability, infrastructure, property and the maintenance and refresh part to give you an indication of where that GBP1bn will be spent.

But it comes back to a bigger point I make at the end which is this is about a business which is -- I think knows what it's doing in terms of wanting to improve its retail operations for customers but just recognizing that for whatever reason we find ourselves in a particular financial situation and we're facing into that and dealing with it in order that we can then invest that back in a model that we know can be competitive (inaudible).

Finally portfolio. And I'm going to take a little detour for a second on portfolio in the hope that it's helpful to you but also in the hope that it's helpful to me so I don't have to explain this too many times more going forward, not so much to yourselves but to other stakeholders in the business. Because I'm going to take a little detour and I'm going to talk about the liquidity and the funding of the Group in a way that we haven't said this to you before. So people are talking to me about the portfolio and to Alan about the portfolio in a way which is you've got to, you've got to, you've got to. And we understand that. In fairness, I think we did face into the issue around the balance sheet very overtly first time out.

What I want to say to you is the following. In the first week that -- the first period I was in the job, and certainly Alan's first week in the job, we secured a GBP5bn facility for the business. So our liquidity and our funding is really robust. It's really robust. And against that we've got a good maturity profile on any bonds upcoming and I've given you some of the details there.

So there's a lot of commentary about the absolute desperation with which I need to dispose of other assets, the so-called in inverted commas fire sale that may come. And I just want to say there's absolutely no need, no need whatsoever. So what we will do is, yes, we are looking at the portfolio, we're doing the review, we will continue to do the review. We've done a bit, I'll tell you a bit more, and we're going to do more. But I just want you to know that's in the background of a very solid liquidity and funding position and not in any way some sort of stressed business need. Okay? Really important.

Okay, what have we done? Relatively small is we announced today that we complete the sale of Blinkbox Movies and Tesco Broadband to TalkTalk. Now I'll say two words on that. Really interesting business, obviously a start-up. We've invested -- it's fair to say we've invested a lot of money. But it's a business that still needs a lot of money if it's to fulfill its potential. And if you look at the finances of the Group, what we're saying is actually for us to be investing there when we don't have what it is and would ideally want in the core of our business is not the right thing for us to be doing. And actually for that business to be part of the core of somebody else who will make that investment and grow it out, that's a better business solution.

Broadband is somewhat similar. It's a good broadband business but we're never going to be the competitive leader in broadband in the UK and so actually it's better for them to be part of a business which is focused directly in that area. So that's a deal that we've done. By the way, we're in exclusive talks on Blinkbox Music and Books as well but they're relatively small, as you know.

The bigger one is obviously dunnhumby and we announced this morning that we do have and we have retained Goldman Sachs to work with as advisors on looking at the options on dunnhumby. Now this is a fantastic business. This is a business of around GBP0.5bn in revenue, around GBP100m of profit, operates in 700 and -- insights in what we call 750m customers and it operates with 20 retail partners. It's a great business. It's a really great business. And it's done extremely well for Tesco.

And what we've looked at is the following, which is the question for us given the overall financial shape of the (technical difficulty) do we need to own it to get the benefit from it? And the answer is probably we don't. In fact, we know we don't. We can do that through other commercial arrangements.

They also a business that needs to have investment and the next wave of data, and therefore there are a number of very interested parties who would want to be involved in dunnhumby. So we've taken Goldman on to look with us about what all those options could be. And what we are saying is we are open to any and all possibilities there. But that's officially kicked off and started.

The one thing I wanted to say is people immediately when you say dunnhumby does that mean a different future for Clubcard. No, it doesn't. Clubcard is still a very strategic and very important part of the Tesco proposition.

Dividend, couldn't think of any pictures at all for dividend I'm afraid. And look, probably is the place I shouldn't be humorous, because obviously shareholders have taken a very big hit in their holding in Tesco. And it gives us no pleasure at all to make a call to say that we won't be paying the final dividend.

It is about protecting the balance sheet; it is about investing in the proposition. And the investors that Alan and I have spoken to when we talk to them about what it is we want to do with the business, nobody wants you to do this but actually everybody understands that it's the right thing to do in the context of everything else. And it comes back to that thing that says actually this is a business -- I believe this is a business worth investing if you run it in the right way, but I'm asking every stakeholder be it an employee, community shareholder to tighten their belts and reinvest and recommit to that as we move forward. And that's what the dividend is about.

Finally and I'll wrap it up, trust and transparency. We talked about brand, ways of working and the investment case. What have we done? Well, you've seen the latest; you've seen the things we did at the end of last year. More pricing you can trust in the way that we are approaching on brands. The new category, that approach that I talked about at length in terms of paper is one that we'll bring to other category reviews within Tesco.

And there's also some things around innovation. Now I did promise Chris that I would not at this point pull out my mobile phone and demonstrate for you. But if you do -- if you are fortunate enough to live in North London or near Richmond you can test something called PayQwiq.

PayQwiq is a fantastic little innovation, which on your smartphone, puts together your Clubcard and your Tesco Bank account, actually any bank account, but my Tesco Bank account, and allows me at the checkout to just call up a code, which pays for my shopping and credits all of my Clubcard in one go, very simple, very smart, just a different way of engaging with customers. And I give it to you as a small example, because one of the things I talked about in October is getting Tesco back to being innovative in its core is I think a real opportunity for our business.

Talk about three other things which we don't talk about a lot, somebody once said to me I've been asked a lot what surprised you about Tesco in the four months. And there are a couple of things. The one I want to talk about now is how big its heart is. And that always surprises people, how big its heart is. The amount that colleagues do for charity is just awe-inspiring. We don't say anything about it. It's almost like our soft secret in a way.

But just to give you some sense for this 0.5m primary school kids march through our store and we give them an experience which is from farm to fork to educate them around food. And if you're in a store and you see a bunch of small kids with aprons on running around that's exactly what's going on and it's absolutely fabulous.

The other thing is in terms of food banks and food collection. Across the Tesco business 21.5m meals provided. In the last one just before Christmas nearly 6m meals were provided. That's customers donating and that's us matching. But that's a really significant investment.

And finally, with Diabetes UK, GBP18m has been raised and actually with one person -- there was a day in Christmas time when I rowed, I cycled, I ran and I hopped as a part of a contribution of getting the team to the North Pole. I've no idea why the North Pole apart from the fact it was Christmas, as part of the fundraising for Diabetes UK. And there's just something about Tesco that people get behind and do this sort of thing really very passionately.

Finally commercial income, well. accounting and the investment case, we talked about trust and transparency. A number of you have talked to us about the fact that we are making our investment case easier and there is a review of all of that going on in terms of how it is we present our business.

Commercial income you know about. The thing I should mention in commercial income is that as we unwind the way that we were doing commercial income historically, and we clearly addressed all of those accounting issues, it will have an impact on how it is we manage the cash at the end of the year as well. So we just give you a [sighter] of that because we won't close out in the same way that we've done in the past.

The other two things which are on Alan's and my radar is, as we talked to you again on October 23, we said to you about stock and stock taking and that we are (technical difficulty) called modern stock take. We've taken two initiatives. We've taken modern stock taking, we've put it across every format in the UK and that's rolling out now. And that's the common base with which we want to do stock across the Tesco world. So that will roll out and we'll see -- we'll do that by the end of the year.

And finally this property review, you've asked us questions about impairment and we get it. The property review is ongoing and that's something we'll address, as you would expect us to, at the end of the financial year.

So final two charts from me, the way ahead, what do I see? Look, as I say, I think we see a small step in the right direction based on the last three or four months but we are also very clear that this is going to be a multi-year effort and commitment.

We've made announcements about some very difficult changes. There's probably not a part of our business that we haven't touched that impacts all stockholders in terms of how it is we need to invest.

There's a high level of volatility. Everybody talks about the volatility in the marketplace. And again I get that. You don't need me to repeat it. The volatility I'm interested in and the bit that's been making it very difficult for me to forecast the business going forward is, as we change the way we invest in prices, change the way that we play in different categories, being able to predict between inflation/deflation, what's happening in the marketplace versus the changes in strategy, I know, don't know, but that's okay. But there is going to be a high volatility as we make those changes in our business.

So when you come off a promotional program to a, like the brand one, do you know exactly what's going to happen? No. So that volatility is one that we are going to embrace. And actually it's where the fun is but it doesn't make financial planning as easy as some might like.

We will constantly, people say what are you going to do? We are going to do the right thing for the customers. We are going to grow really big ears and really enquiring minds with our customers, and then we are going to give them what it is they most want in the way that only Tesco can.

And we've started on the balance sheet. Key word, we've started on the balance sheet. We get it. We know we want to do more. We will do more. I'd just ask you to respect that we'll do that in the most value accretive way.

The first call, the first call for any improvement we have in the underlying business will be back into the customer proposition. We'll get that into customer proposition, because we see that the sustainable recovery for Tesco is to actually get that volume growth momentum. So anything we can get in the short term we invest back into our business to get the volume and those offer (technical difficulty) affects the medium term opportunity to improve and recover the margin position. But we need to invest in the business.

So we'll be very financial disciplined. Between Alan, myself and everybody we've set ourselves some very tight financial parameters, we've been very, very disciplined and have a particular focus on cash.

So, I told you I think we've invested in our core service, our availability and selectively in price. We've improved and I've shown you the detail about what the customer thinks and the metrics that are related to that.

And the period to Christmas was an encouraging first step, but it was a first step and nobody is under any illusion that we've got much, much more than we need to do.

We've announced a significant cost reduction program. And we've made our first step in progressing the balance sheet improvement. And we've also started with more initiatives about why it is the customer should engage more with our brand proposition.

We will always put the customer first. We are reshaping the relationships with our suppliers and the way that you've heard me talk about and that carries on.

And the final thing from me is treating our colleagues and our communities fairly and with dignity. I've been through these sorts of change programs before, and it's very important to me that we treat the colleagues who have been part of building Tesco in the right way as we walk through the consequences of some of the changes that we've made, likewise in the communities.

Those are the priorities. Any questions? Bruno, why don't you go first?

QUESTIONS AND ANSWERS

Bruno Monteyne - *Sanford Bernstein - Analyst*

Good morning. So three questions, a lot of that is about solid good retailing but there was one thing that stands a bit in the other direction which is the cut in CapEx. I can see why you do it, but how long do you think you can keep CapEx at these levels before you still need to have healthy, good looking stores.

The second one is from your talks with the rating agencies do you feel you've done enough, do you have enough leeway with them protect your current rating.

And the third one is about space. I know you've closed 43 stores but that's a very small percentage of space 1% or 2%. So do you have any plans on how to re-utilize the excess space in stores that are simply too big where you can't close them because it's too big of a store. Thank you.

Dave Lewis - *Tesco plc - CEO*

Do you want to have a go?

Alan Stewart - *Tesco plc - CFO*

I said I'd take the first two I may pass the third space back to you. In terms of CapEx we have looked at this and this is next year, we are guiding for next year at GBP1bn but we do believe that this is the right level of CapEx. We don't believe the business is going to suffer (technical difficulty) of that.

And as the pie chart shows those of you can remember what (technical difficulty) get it out, I'll tell you it's about just over 26%, in the one category, about 26 in the other category property and then the maintenance and then the final infrastructure and investment is the balance of around 48%.

So those are what we believe is the right level of CapEx for the business. We do not believe it's going to suffer. And we'll take CapEx as we go through the future years. But just to be clear it's not that we've put a lid on the CapEx this year with a pressure cooker underneath that it's going to balance back in future years. That's not the way we are approaching it. And we don't believe the business will suffer. We are looking for returns and we are looking for productivity from -- gains from that CapEx.

In terms of the rating agencies, a really good question, pre the December announcement we hadn't met with the rating agencies ahead of the last announcement on December 9. Yesterday, I met with all three rating agencies and spent many hours with them. I think they are very clear on the actions we are taking and we're very clear on the approach we are taking which is exactly what we've set out here today. And we are committed in terms of the engagement we have with them that we will continue to have an open and transparent dialogue with them.

We will try to run the business in order to be an investment grade company. That's what we will try to do and that's what we would seek to do. But they will form their view based on how they take our plans (technical difficulty), take up their -- form their view and frankly it's for them to form that. And so we are very conscious of the responsibilities we have. And if the rating maintains, that would be absolutely tremendous that's where we would like to be. If the rating drops then we will manage that and we will work through it, and we'll get to a place that we are able to operate in an investment grade (inaudible).

In terms of the space, it is small; I think it's very important. I don't know if you want to answer it or --.

Dave Lewis - *Tesco plc - CEO*

I'd just say we've been clear about what it is we are going to close, and then we are going to be very creative with what we do with the space that we still have. So I do see opportunities and we do have some thoughts about how it is we might re-utilize that space. But let me do it first and then we'll share it with you.

Go ahead, go with Mr. McCarthy and then we'll go --. Is that all right? It feels very strange sitting down here. Do you mind if I stand up while you're -- it feels bizarre.

Dave McCarthy - *HSBC - Analyst*

Are you now standing?

Dave Lewis - *Tesco plc - CEO*

Yes.

Dave McCarthy - *HSBC - Analyst*

A couple of questions, one on pricing. You've changed the pricing of these but you know one of my bugbears is the price architecture. So it's very easy to change your 750 gram of Kellogg's but what about the rest of the category, the substitutions, the different pack sizes, different brands, own label, etc?

Then secondly, just following on on that property thing, do you think too much is made out of you've got too many big stores? I ask the question how many mezzanines have you got, how many of them are appropriate. I think there is a bit of a (inaudible) there that you've got this major problem. Do you think it is a major problem?

Dave Lewis - *Tesco plc - CEO*

So first answer to the question because I know this is one of your hobby horses, so if you look at the points of comparison here I think it's about 117 where the direct comparisons would be. And the number of lines is actually that's changed is about 300, David. And that's because we want to keep the pricing architecture of size correct. So not just change one, we keep all of it correct. And we keep the variance in the same way.

And because it's brand it's obviously contained within the brand and that works. So we've just I think taken account if you would. If you were doing it just on point per point it would be 117 I think the number is but it's actually 300 because you take account of the things that you're talking about so that's invested in.

Second thing is I don't see the big stores as a big problem in the way that people talk about. I see it that there is an opportunity that we could do better with them. I do think it probably would have been -- the impact on capital of building yet more of them and then running them, I don't see that as the right thing to do and that's why I've stopped it. But actually in the vast majority of the big stores that we have I actually see an opportunity for us to think about how we use the space differently rather than see it as a problem. And I think as a management team it's imperative that we do see it that way.

Clive Black - *Shore Capital - Analyst*

Clive Black. I'll just ask a single question, (technical difficulty).

Alan Stewart - *Tesco plc - CFO*

What we've spoken about on the dividend is for this year. In terms of what we need to do at the time, and I'm not going to give a time on it, but what we need to do is we need to get the leverage in the business to a state that it's not growing and that it's actually coming down. We need to get the business performance improving as well because it's the cash generation which is important for the business.

And if you look at the -- it's no secret that this year we will have quite a significant cash outflow. And if you look at where the analysts' model are if you take the cash generated compared with the CapEx the dividend, the tax, working capital movement which Dave has alluded to, then there is a negative outflow.

And we can't afford to pay our shareholders. And they wouldn't want us to be paying dividends when we are growing the leverage in the balance sheet as well. So it's reducing the leverage, generating free cash and that's the point at which we can then think about dividend and payments. When that comes? We'll see.

But specifically we are only talking about this year. And don't say -- don't think that we'll see means that I'm indicating a long time either; I'm only talking about this year.

Mike Dennis - *Cantor Fitzgerald - Analyst*

Thanks, Mike Dennis, from Cantor Fitzgerald. I've got a few questions. Firstly in terms of the cash flow, could you tell us what the policy change in commercial income has done for the cash flow because I'm having trouble with your second half and into next year? Is the shift, the quantum shift in the UK is that in the hundreds of millions the policy change there just so we can get that clear?

And in terms of cost is 0.6% of your sales, this GBP250m of the UK sales, isn't that a bit low given the step change in the past with more like 1.6%. Is there a lot more cost savings to come? That's the second question.

And in terms of IFRIC you seem to have -- the 5.1% like for like negative includes 0.9%. Is that now going to carry -- you seem to have -- the 5.1% like for like negative includes 0.9%. Is that now going to carry on for the whole of this year that you're going to have 1% vouchering in your like for likes or is that the end of that and you're moving onto this new [EDLP] so we don't expect to see that negative in those like for likes going forward.

And I've got some other questions, but I'll start with that.

Alan Stewart - *Tesco plc - CFO*

We might have to put a limit on the number of questions we allow people to ask, so let's deal with those three. In terms of the cash, we are still working through the commercial income as you know and we flagged it and that's contained within the GBP1.4bn guidelines.

One of the areas which we want to change the way that we talk to our suppliers about is cash as part of that discussion. So we will see some outflow in terms of our working capital because of the unwind of the overall cash position.

Without being definitive as to numbers the range of cash outflow that I would expect us to close this year, year on year, is around of GBP2.3bn outflow of cash compared with where we were at the start of the year. And that's around the guidance of the CapEx which is GBP2.1bn maybe slightly higher in terms of the cash impact of CapEx. And we've then got the dividends with the interest and tax. We've got some of the investments we've made which we spoke about back in the October presentation. And we've had disposals of businesses plus of course then we've got the impact of working capital.

So that would broadly add up and these are broad numbers -- please we haven't closed the year yet -- of around GBP2.3bn. So we then would be in a position where we are no longer talking to suppliers about cash as part of the commercial arrangements, and we can then get onto a different discussion with the suppliers.

In terms of the cost, a 30% reduction in our office cost of people is I think a fairly significant number and it's quantified as a one-off cost of about GBP300m with a GBP250m annual saving, maybe a bit more than that as we get to the end.

In terms of IFRIC and this is a very technical question obviously, but I don't think there's been any change year on year in terms of the vouchering. The way that the IFRIC adjustment works across our period end depends on when the particular promotions were launched. So I hope -- there hasn't been a change and you can see

THOMSON REUTERS

very clearly that our promotional, where we are putting our effort is in pricing in front of the customer. But we'll see how that works out, but I wouldn't expect it -- I certainly wouldn't expect it to rise.

Dave Lewis - *Tesco plc - CEO*

Okay, we'll go here and then here if we may and then just and -- order of that please.

John Kershaw - *Exane BNP Paribas - Analyst*

John Kershaw from Exane. Three quick ones from me. You talked about almost the excitement of not knowing what happens when you detox from promotions. Can you give us a sense of how radical you might be because a certain Mr. Coupe at Sainsbury's suggested it was a very dangerous thing on the conference call yesterday? So perhaps he's too timid, but perhaps talk to that.

Secondly, just coming back to David McCarthy's bugbear, own label there's a lot of problems within the branded architecture but own label good, better, best arguably there is even more structural issue with all the discounts done. So expand on what you think about that.

And finally, how long does it take to fix a brand with your FMCG pattern?

Dave Lewis - *Tesco plc - CEO*

So I think no comment on what Mike may have said. So from my point of view, we as Tesco need to decide what the pricing strategy is for us. We'll do that category by category based on customer experience. We'll obviously look at the relative but we'll do it based on what it is the proposition is that Tesco deliver.

We will change the way that we support our business. And again it will be different by category. Everybody wants it to be one base, everything in [one] base and everything. It won't be like that at all. It will be horses for courses, category by category and we'll play it in the best way we think is right for customers.

In terms of -- I would agree with you, we would agree with you there's opportunity within our own brand offering and we'll work on that and you'll see us work on that. And you know I won't tell you what it is we are going to do before we do it, so please respect that.

And finally, it always depends what it is that ails the brand. The thing that I think is really interesting in the context of Tesco is despite all of the challenges, and you know there have been some, and all of the things that I've experienced in the time that I've been here, customers are still coming to our store. And it's a very interesting thing. If you look at the footfall through this period, the footfall has improved.

So the question for me is if customers are still coming to our store that's an opportunity for me to give them an experience that they didn't expect such that they come back again and give us more of their custom. And if I have that then actually it comes to those reasons to re-engage with the brand that I talked about but didn't give you any detail on, which is what will unfold as we go forward through the years.

But let's not kid ourselves, we've got a long way to go. There's lots of things we need to do. But we think we know in which direction we ought to be going.

David Cumming – *Standard Life – Head of Equities*

(Technical difficulty). Sales category in terms of market share, I just mean to say if you take a two to three year view how you see the competitive threats. Because our people think it might flatten out at a natural level of 15% as the macro gets better, etc. But I just wondered how you see the threat between the two of you and whether it's likely to change.

Dave Lewis - *Tesco plc - CEO*

So first things first the -- it wasn't a question of bravery, it's an external source that doesn't include [Aldi or Lidl in] their panel so if it were there I would share it with you. So I see the opportunity for Tesco to be one that offers a very real and very credible competitive offering to anybody else who wants to operate in the UK retail space. So I respect the competition of discount, I respect the model that's there. But I also feel that there is an opportunity for Tesco to be as competitive with that offering as it is with other multi-category retailers.

Now that's an easy thing to say. We'll have to see how we go. For me, the real focus for us is put the customer first. Let's put ourselves, listen to customers in a way that is really very well attuned, and then as they come into the store give them things that they want from Tesco and therefore don't give them a reason to go somewhere else. And that's the job for me and my team. And if we can do that better than anybody else we'll be fine.

Okay, these two up first and then we'll come to the lady here.

Jaime Vazquez - *JPMorgan - Analyst*

Hi, Jaime Vazquez from JPMorgan. Three or four questions quick, all financial, what net debt should we expect for the end of the year as per your working capital comment?

Second question, you're going to conduct an asset review, will there be a need to review your depreciation policies do you think mainly on non-property assets?

The third question is with the commercial income how much of the commercial income lost this year from a P&L point of view do you think will be recovered next year through then from margin?

And a quick one is what should we think of the negative contribution of Blinkbox this year just to get that benefit next year.

Alan Stewart - *Tesco plc - CFO*

Right in terms of net debt I'm going to have to come back to you because I've looked at it more from a cash outflow perspective in terms of what the net debt number is.

In terms of the review we will continue the review. We will do it and we will come back at the right time. But the important point in terms of the review is that we are not under any pressure to do it. What we are making the right choices are is from a business perspective what's right and if part of the business is not appropriate to our strategy then we will want to get the maximum value from that business at the appropriate time.

Jaime Vazquez - *JPMorgan - Analyst*

Do you think (technical difficulty)?

Alan Stewart - *Tesco plc - CFO*

In respect of?

Jaime Vazquez - *JPMorgan - Analyst*

Are you depreciating your assets --?

Alan Stewart - *Tesco plc - CFO*

Oh sorry, I thought you were talking about the portfolio review. No, in terms of the -- yes I do, yes I do. And we can go into a lot of detail. I think we've gone into a lot of detail. If people -- I absolutely believe it's appropriate. I absolutely believe that we are not stretching depreciation. And if that's the question you're asking I believe it. If we can't prove it to you then I'm sorry but we can't do any more. But I absolutely believe that.

Jaime Vazquez - *JPMorgan - Analyst*

That's good enough, thank you.

Alan Stewart - *Tesco plc - CFO*

Thank you. With the commercial income I think we've said that this is uncertainty, we've said that we will engage and I don't think it would be appropriate for us to call what that means. And to the extent that there is a benefit as we move forward for margin what we've been clear is that the priority is going to be investing in the customer proposition. So to a certain degree it becomes perhaps a circular argument so in the immediate future.

And then in terms of Blinkbox I think you're right, there will be some benefits. It will be a discontinued operation. Dave spoke about the losses that it makes. And we are investing significantly in that. That will clearly benefit call it around GBP50m a year that we've been investing in it. I don't know what you've factored in for next year in your model but that's what will probably be around the level that we've got.

Jaime Vazquez - *JPMorgan - Analyst*

Thank you.

Rob Joyce - *Goldman Sachs - Analyst*

Hi, Rob Joyce from Goldman Sachs. Three from me, so firstly on the price cuts you announced this morning should we consider that as permanent price cuts? And how many of those are funded by you and how many by suppliers and what percentage are?

Dave Lewis - *Tesco plc - CEO*

The funding is all by us. And they're permanent price reductions we won't be promoting, but we will -- what we've said to ourselves is we'll run that for three months and then we'll ask ourselves and our customers how it is they felt that that was -- was that the right thing to do and then we'll review whether we do more of it, less of it. But it's a change in approach and it's funded by Tesco.

Rob Joyce - *Goldman Sachs - Analyst*

Okay, thanks. A couple for Alan probably just in terms of the UK property portfolio, could you update us on what percentage of the space is freehold?

And the second one is just you spoke to the rating agencies, what do you think you're -- the right leverage level is for this business on a sustainable medium-term basis? Thanks.

Alan Stewart - *Tesco plc - CFO*

In terms of property we gave the figure of 53% for the Group and the UK is somewhat a bit lower than that. There hasn't been any significant change in that since we last updated on October 23. It's clearly an element of further review and we are looking at that and as Dave has said property review continues and all the aspects of that.

In respect to the rating agencies I really don't know at this stage. I think we gave them a lot to think about yesterday. Some of them may make a decision sooner rather than later. And what became very clear to me in the discussions is that they understand what we are doing and they understand the importance of making a decision on the rating from their perspective as well. And they will do it. And we will respect that whatever it is, and we will see when they come out and we will continue to engage with them.

Dave Lewis - *Tesco plc - CEO*

We'll go down here next and then we'll go to the back of the room and then -- sorry -- trying to -- behind you.

Arnaud Joly - *Societe Generale - Analyst*

Thank you. Arnaud Joly, Soc Gen. I have two questions. The first one regarding real estate for PPE impairment test your competitors last year used discount rates of between 6.5% and 9%. In your annual report for last year you gave a range of between 6% and 14%. Could you please give us the average discount rate you used [that would be helpful]?

And the second question regarding cost cutting. In the announced GBP250m of cost cutting do you have any specific action plans on logistics and IT? And if not, do you see any scope to deliver more cost cutting on this side? Thank you.

Alan Stewart - *Tesco plc - CFO*

Okay, in terms of the discount rate, if you're asking what the average was for last year then we can take that off line. In terms of the current year, which is probably a more relevant one, we are going through all of that exercise now. We have our year end in February and then with the finals, [with the preliminary] results, we will give the colour that we normally would on that.

But what I would like to say about the exercise impairment is that we are in the middle of a comprehensive review of that. We are looking at the correct discount rates and look across each of the territories that we are operating in. We are looking at the consistency of approach of that -- of the impairment methodology. And then finally of course we have to then, because this is a technical area, we have to take our expectation of future cash flows and we have to look at that against the lower of the carrying value. And having, or rather we discount the cash flows, we then compare it with the market value of the asset and we then compare it with our book value.

So it's a pretty complex exercise. We've been doing it comprehensively and consistently across the whole Group appropriate to the [way] we are now. To call it where it is today very difficult to say I think there will be some impairment which comes through.

In respect of the logistics and the supply chain specifically, what we've been talking about is the structure which is a head office structure, and as we work through what that means we are limiting it to that at the moment.

Dave Lewis - *Tesco plc - CEO*

Lady here next and then gentleman at the back, we'll try and do it in the order that they started.

Kate Pettem - *Rathbone Brothers Plc - Analyst*

Kate Pettem from Rathbone. When Matt Davies joined Halfords he instigated a comprehensive turnaround program there that impacted on margins. Part of it was a service proposition that's multi-year. Would Tesco UK be prepared to take some EBIT margin to allow him to undertake comprehensive (technical difficulty) like that one.

In addition, along the FMCG question, he also told investors that to properly change customer's perceptions of a retail brand in his experience would take four to five years. Would you comment on that please?

Dave Lewis - *Tesco plc - CEO*

I think comments on both of them. I think it's fair to say I think we've taken quite an impact on earnings already as part of resetting the UK experience for customers. And what I'm saying is that we do see an opportunity and a need for us to invest more but we want to do that by our creating those funds ourselves.

So Matt will have an opportunity and the reason Matt's coming is he has a chance to bring his skills and experience and his review to it. Obviously we are working on it already and so we think we know what the investment parameters are. But it's quite a dynamic thing and I'm looking forward to his point of view. But I don't think he's coming with a strategy in mind in the way that you suggest. I've shared with him what it is we are doing and he seems extremely happy and excited by it, and that's obviously why he's decided to come.

I think what's one of the things for Matt that will be new and exciting about Tesco is just the pace and the frequency with which. So, it's one of those things which is in the retail brand you can only change the perception of the brand based on the number of times that you engage with it. So I know nothing at all about Halfords in any sort of real detail, but in terms of the frequency with which.

The great thing about a brand like Tesco is the touch points and the frequency are so high that if you change the experience people get it really quickly, really quickly. And it's really been very interesting through the Christmas period how quickly. If you surprise a customer with something that they weren't expecting, how important that is in terms of their positioning and their view of the brand almost the very next day.

It doesn't mean to say that their perception changes completely, but their willingness to engage with you goes up really quite quickly. And therefore I think the timing for Tesco could be shorter than that. I don't know what he was basing that on, but actually I've been really quite surprised at how quickly you can have a positive impact and it's something that people really want to have.

Second one at the back please.

James Grzinic - *Jefferies - Analyst*

It's James Grzinic from Jefferies. I just had a couple really. First one is can you perhaps talk about the net change in pricing in the categories you've done post the promotional investment being pulled rather than giving us the reverse price point change to get a better feel on the value changes.

Dave Lewis - *Tesco plc - CEO*

Short answer is no, I can't I haven't done the sums. I can tell you that if you look at the prices in December and the prices as of now an average of the ones we've changed its 26% lower. But I've not gone back and looked at it in the way that you've just suggest. I'm sorry I can't.

James Grzinic - *Jefferies - Analyst*

With your history how much could you make your international scale really work for you on terms with suppliers?

Dave Lewis - *Tesco plc - CEO*

I think there's some opportunity. I think there's some opportunity. I think it comes to -- I think there is an opportunity for us to think about how it is we run our business so it's more receptive to that sort of leverage and scale. And there's an opportunity for us to do that. Because I think if we operate our business in let's say 12 different countries, 12 different ways then it's very difficult to engage with suppliers and get the benefit across the 12.

If we are able to sort of align and think through then I think there are some opportunities which quite frankly up till now we haven't taken. But there are things more for us to be working on I don't have an example that I could give to you right now of that, but there are some opportunities there definitely.

James Grzinic - *Jefferies - Analyst*

And lastly just a numbers question, how much space will you open with GBP150m of CapEx and the new budget globally and how much in the UK I'd be interested in. Thank you.

Alan Stewart - *Tesco plc - CFO*

I'm sorry I haven't worked it through. I'll have to come back to you and answer what the answer to the other space build there.

Dave Lewis - *Tesco plc - CEO*

To give you one bit for there, which is an important one, and I haven't got the square meterage either, but as we talk about the 49 sites that we are not going to build, we'll be really clear, there are 23 that we are. So the two to three years we will -- there are still 23 that we think are absolutely the right thing to do and are a very good financial investment. So it's not that we are stopping; it's just that the 49 that we don't think -- we are not doing but the 23 will go ahead. I haven't -- I can't remember the square meterage but we can share that.

Alan Stewart - *Tesco plc - CFO*

And a bit more color on those given that we've now spoken about them, they are contained in the CapEx guidance. It's around GBP75m a year that we'll be spending on it. So they are contained within what we've said. And in the GBP1bn there is about GBP75m next year.

Dave Lewis - *Tesco plc - CEO*

Over this side of the room, we'll take the gentleman just there for logistics sense and then down here please.

Rickin Thakrar - *Espirito Santo Research - Analyst*

Hi. It's Rickin Thakrar from Espirito. A couple of questions, Dave. The first is on your margins, do you see a downside risk to your margins near term with this price investment?

The second question is on your pricing architecture. Are you saying that it would be very clearly that you can buy cheaper for bulk products consistently across the board, because it's pretty inconsistent right now, would you comment on that.

And finally, the Christmas period was fairly heavily promotional for you. Do you think you can sustain that level of promotion going forward?

Dave Lewis - *Tesco plc - CEO*

I'll go back in reverse order and see if I remember the first question. So actually obviously there is promotional intensity at Christmas. If you look at promotional intensity this Christmas versus the amount of promotions investment that we had last Christmas, it's less this year than last year. So we promoted less this year than we did last year we just promoted in a different way.

I don't see the price -- I take your point about inconsistency and that comes back to the reason I gave you that chart of the year and why I told you that there are different things I am doing on individual lines and different things I'll do through a range reviews and different things I'll do through promotions as I do it in the right way for customers as we walk through the year. So we will do it and you won't -- you will see us play it category by category by category.

And to the point about the price investment, we -- and what the impact on the margins, we said that what was it December 9, GBP1.4bn and if you read very specifically what we said there it was GBP1.4bn with all the initiatives that we had announced to that date. What we've said here is we are going to keep the GBP1.4bn guidance having launched a new initiative. So we are funding that within there.

So what we are trying to do, I suppose what I'm trying to get to is get into a place that says if we can generate, if we can generate new funds by growing our volume ahead of where we had thought we were or indeed being more cost effective in other parts of, that actually I do feel that I could take that money and for shareholders and for customers make strategic investments on which I'm going to get a much better return into the medium term.

THOMSON REUTERS

So rather than giving that back to a margin expansion in the immediate term I'm going to put that back into addressing that customer proposition as I move through the portfolio and change some of our legacy positions. And that's the sense I'm trying to give you. I know you want the specific number, but that's the dynamic nature that we are going to try and manage the business.

Rickin Thakrar - *Espirito Santo Research - Analyst*

Thanks.

Charlie Storey - *Macquarie - Analyst*

Charlie Storey from Macquarie. Just one question on Europe. You had very strong Christmas like for likes especially impressive given the context of seasonal deflation, at least in Europe. Are you doing anything differently there? Previously we thought maybe you weren't recovering cost of capital. I know you've been focusing on the UK business. Do you now focus your energies more in Europe or have they had some of the customer service improvements as well?

Dave Lewis - *Tesco plc - CEO*

I think I give credit to Ken and his team. I think what they did was they set the business up very well for the trading period and were very competitive in the marketplace. So it's not about a change in focus for me; it's about a good performance and the team on the ground and given all the situations that you've mentioned.

And look the challenges in Europe will still stay. You know what's -- the Hungarian situation is one that we are going to have to face into as we go forward. But fair play to the team, they did some very good work in the fourth quarter and they saw a positive result for it.

Charlie Storey - *Macquarie - Analyst*

Is it more market share rather than macro do you think? Thanks.

Dave Lewis - *Tesco plc - CEO*

Yes. And one more over -- sorry, I think we are nearly there.

James Collins - *Oriel Securities - Analyst*

Thanks very much. It's James Collins from Oriel Securities. Just two questions back on the UK. And so on Tesco Direct can you give us some indication of what the profitability that is? Clearly you've done some good growth, but is it [margin dilutive or] accretive? And a similar question on non-food more generally, non-food in store, again profitability and what's the prospect for profitability there?

And then a question on fuel save. What's it doing for the business? It looks like your fuel volumes are very good. And do you think that it's the right kind of investment that the business should be making?

Alan Stewart - *Tesco plc - CFO*

I'll take fuel, so in terms of the profitability in the time I've been there I haven't fully got into the way that we calculate profitability which is on specific parts of the business. We can obviously give the direct costs and you can look at them, but when you get into businesses which touch different parts of the business you actually need to look at it through different lenses and I just haven't done that.

I think the important thing is that the challenge in any of our businesses as we know is in ensuring that as you grow the business you are not destroying value because you're charging more. And it is about the efficiency of the investment and the efficiency of the throughput through your DCs as well. It's a question that frankly I just don't know the answer now. But it's a key point of understanding and I'm sure that it's something which when Matt gets into the UK team it would be a good question because remember he's a background of a finance background as well.

Dave Lewis - *Tesco plc - CEO*

I can give a bit just building on that. So the plan within grocery home shopping is as we continue to -- so we made some investments around delivery charges earlier this year and we've seen that respond in terms of volume and indeed market share. And there's a very clear plan as to how that can be leveraged into a recovery of profitability from that investment.

In general merchandising it is more challenged, it is more challenging. We never declare the number but it's more challenged and it's something very specific there to be done. There's a plan that is there. It's a plan that will take six or nine months to come to fruition so we shall probably share it with you when we get to the full year. And it will be interesting to have Matt's view on some of that.

But the key to that was growth, and we've shown that we know how to grow it. And therefore the question for us is how quickly we will leverage that into a more profitable position, because I think we've been clear before it's not at the profit level that we would want it to be at.

Fuel save, fuel save is very much valued by our customer offering, it's really highly valued by those who use it. I think the question that we've got to ask ourselves, the very dynamic question is, as the petrol price comes down does that have an impact on its effectiveness as an offer. We are all asking that question. So I don't know the answer to it, but obviously it's quite a dynamic space. But as an action over the last week it's been very effective, and we cannot even talk about the volume.

Any more burning? Two more? I'll tell you what let's take these two as the last two and then we'll, if you don't mind, call it a day.

Xavier Le Mene – *Bank of America Merrill Lynch – Analyst*

Xavier Le Mene from Bank of America Merrill Lynch. Two questions if I may, it sounds like your process is really to drive the sales up to increase the like for like which was still in the low inflation environment. So how long do you think it can take for Tesco to recovery the like for like to positive territory?

And the second question is you talk about margin, it sounds like the UK margin will be below 1% this year, you say that you are not going to see margin expansion till next year so let's guess another 1% of EBIT margin for the UK for 2016. What is your long-term prospect? What do you think Tesco can achieve in the mid to long-term environment?

Dave Lewis - *Tesco plc - CEO*

Okay. I'm not going to use a crystal ball in trying to forecast when the positive like for like is. We are going to run the business and we'll see where the -- it depends on so many different variables so it would be a foolish thing for me to predict.

But in terms of the margins I think what I'm saying to you is I think there is a model for it. And clearly I'm not going to give you a number for margins. But do I think that if we invest in the right way is there a medium-term position for Tesco to be in the UK at above -- slightly above industry margins? I believe there is. But we need to invest back in this business and that's what we are going to do but we are going to do that by creating our own space to do it.

Final question. Sir, do you want to pass the microphone behind you is that okay?

Pradeep Pratti - *Citigroup - Analyst*

Hi there. Pradeep Pratti from Citi. Two questions, one on CapEx, what's the split of the GBP1bn in terms of regions? How much are you [allocating] between Europe and Asia next year?

And the second thing on Europe, especially in Ireland has some of the same problems that you see in the UK in terms of competition from discounters, do you foresee the need to do a big margin reset in Ireland similar to what you've done in the UK?

Alan Stewart - *Tesco plc - CFO*

In terms of the CapEx of the GBP1bn, around 60% of it is UK focused around the balance is the rest of the world. Clearly there are markets which are growing strongly and there is -- and not much of it in respect to your specific question, I think from memory it's between 10% and 15% is going into Europe specifically in terms of the way that we've -- it's going.

In terms of Ireland, yes, it's a market which is clearly very, very competitive. And as Dave has said and we'll come back to, we are not going to talk about what we are doing commercially ahead of whatever we do commercially.

Dave Lewis - *Tesco plc - CEO*

Indeed, and the benefit for us is that actually the similarity of the Irish situation with the UK one from an operational point of view having them with the same operating space we think is a -- is an improvement in our way of designing so that we can learn from each.

Ladies and gentlemen, thank you very much for your time and your attention. I suppose the last thought I'd leave you with is people had said to me before and since I joined that they were concerned that there was a lack of experience and expertise in retailing in Tesco.

If you take one thing out of today I hope you can see that over the last three or four months actually I think the team has done an extremely good job in getting back to what I think Bruno called some very good basic retail way of working. It's a start. It's a start. We are not in any way kidding ourselves. It's a step in the right direction we think. It gives us confidence to invest more in the business.

But we know exactly where we stand financially and we are just going to face into the realities all the things you saw today as a managing team, facing into the reality of it. And what it's saying is actually if you face into the reality and you create the funds that actually the best thing that we can do for shareholders at this point is to invest those funds back in this business, because we can see how it is that becomes more attractive going forward than perhaps it's been in the last couple of years.

So thank you very much for your time and trouble and your questions. And we'll see you again April. Thank you.